COUNCIL
28 SEPTEMBER 2023

TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL INDICATORS 2022/23

Responsible Cabinet Member - Councillor Mandy Porter, Resources Portfolio

Responsible Director – Elizabeth Davison, Group Director of Operations

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SUMMARY REPORT

Purpose of the Report

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and by regulations issued under the Local Government Act 2003 to produce an annual treasury management review that covers treasury activity for 2022/23. The report also seeks approval of the Prudential Indicators results for 2022/23 in accordance with the Prudential Code.

Summary

2. The financial year 2022/23 was yet another unprecedented year with regards to treasury management. With the invasion of Ukraine, cost of living increases and inflation rising to over 10% the cost of borrowing has risen steadily throughout 2022/23 starting the year at 0.75% and finishing at 4.25%. This has led to some significant financial challenges throughout the year. These challenges are expected to continue into 2023/24 with the cost of borrowing continuing to rise. Although the returns for cash investments have also increased due to higher interest rates they still remain below the cost of borrowing.

3. During 2022/23 the Council complied with its legislative and regulatory requirements. The borrowing need (Table 1) was only increased for capital purposes.

4. At 31 March 2023 the Council's external debt was £138.014m which is £11.635m less than the previous year, this reduction relates to not re-borrowing for matured debt due where possible. The average interest rate for borrowing reduced from 2.47% in 2021/22 to 2.41% in 2022/23. Investments totalled £40.044m at 31 March 2023 (£63.399m at 31st March 2022) earning interest of 2.88% on short term cash investments and 1.99% on Property Fund units net of costs.

5. Financing costs have been reduced during the year and a saving of £0.194m has been achieved from the original MTFP. The savings are a mixture of reduced interest charges on debt as well as increased investment income.

Recommendations

6. It is recommended that:

    (a) The outturn 2022/23 Prudential Indicators within this report and those in **Appendix 1** be noted.

    (b) The Treasury Management Annual Report for 2022/23 be noted.

Reasons

7. The recommendations are supported by the following reasons:

    (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.

    (b) To inform members of the Performance of the Treasury Management function.

    (c) To comply with the requirements of the Local Government Act 2003.

Elizabeth Davison
Group Director of Operations

Background Papers
(i) Accounting Records
(ii) Annual Investment Strategy 2022/23
(iii) Prudential Indicators and Treasury Management Strategy Report 2022/23

Judith Murray: Extension 5204

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Carbon Impact and Climate Change	There are no issues relating to carbon impact and climate change
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific group
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is not an Executive decision
Urgent Decision	This is not an Executive decision
Council Plan	The proposals in the report support delivery of the Council Plan through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that have enabled officers to take advantage of different types of Investments and changing interest rates to benefit the Revenue MTFP.
Impact on Looked After Children and Care Leavers	This report does not impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

8. This report summarises:

    (a) Capital expenditure and financing for 2022/23
    (b) The Council's overall borrowing need
    (c) Treasury position at 31st March 2023
    (d) Prudential indicators and compliance issues
    (e) The economic background for 2022/23
    (f) A summary of the Treasury Management Strategy agreed for 2022/23
    (g) Treasury Management activity during 2022/23
    (h) Performance and risk benchmarking

9. Throughout this report a number of technical terms are used, a glossary of terms can be found at the end of this report.

The Council's Capital Expenditure and Financing 2022/23

10. The Council undertakes capital expenditure on long term assets, which is financed either,

    (a) Immediately through capital receipts, capital grants, contributions and from revenue; or

    (b) If insufficient financing is available, by borrowing.

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.

12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £15.203m less than planned, mostly down to reduced activity in the HRA and reduced lending to the joint ventures. However, the mix of funding differs from that which was expected as some schemes progressed quicker than others. This impacted on the borrowing needed to fund expenditure which was £2.607m higher than initially anticipated.

Table 1 – Capital Expenditure and Financing

	2021/22	2022/23		
	Outturn £m	Revised Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	26.072	55.315	42.984	(12.331)
HRA Capital Expenditure	10.729	16.359	14.708	(1.651)
Loans to Joint Ventures etc	6.587	6.165	4.944	(1.221)
Total Capital Expenditure	**43.388**	**77.839**	**62.636**	**(15.203)**
Resourced by:				
Capital Receipts GF	0.586	0.794	0.623	(0.171)
Capital receipts Housing	0.986	0.303	0.433	0.130
JV Loans Repaid	7.927	6.373	5.073	(1.300)
Capital Grants	19.371	39.643	34.466	(5.177)
Capital Contributions	0.038	0.000	0.407	0.407
Revenue Contributions - GF	0.123	0.000	0.187	0.187
Investment Fund - Housing	0.000	2.672	0.000	(2.672)
Revenue Contributions - HRA	8.502	13.384	13.289	(0.095)
Self-Financing - GF	0.000	9.119	0.000	(9.119)
Total Resources	**37.533**	**72.288**	**54.478**	**(17.810)**
Borrowing needed to finance expenditure	**5.855**	**5.551**	**8.158**	**2.607**

The Council's Overall Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents 2022/23 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

14. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through Public Works Loan Board (PWLB), or the money markets) or utilising temporary cash resources within the Council.

15. The Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

16. The total CFR can be reduced each year through a Voluntary Revenue Provision (VRP) or by the application of additional capital financing resources (such as unapplied capital receipts).

17. The Council's CFR for the year is shown in Table 2 and represents a key prudential indicator. The CFR outturn for 2022/23 is £228.660m which is £0.204m higher than approved due to the increased borrowing need required to finance capital expenditure in 2022/23.

Table 2 - Capital Financing Requirement

	2021/22	**2022/23**		
	Outturn £m	**Approved Indicator £m**	**31 March Actual £m**	**Variance £m**
Opening Balance	220.685	224.285	224.285	0.000
Add Capital Expenditure financed by borrowing	13.782	12.143	13.232	1.089
Less repayment of JV loans	(7.927)	(6.373)	(5.073)	1.300
Less MRP/VRP GF	(0.500)	(0.000)	(0.000)	(0.000)
Less MRP/VRP Housing	(0.629)	(0.484)	(2.669)	(2.185)
Less MRP/VRP PFI	(1.126)	(1.115)	(1.115)	0.000
Closing balance	**224.285**	**228.456**	**228.660**	**0.204**

Treasury Position at 31 March 2023

18. Whilst the measure of the Council's underlying need to borrow is the CFR, the Group Director of Operations can manage the Council's actual borrowing position by:

    (a) Borrowing to the CFR level; or

    (b) Choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or

    (c) Borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).

19. The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting and through officer activity detailed in the Council's Treasury Management Practices.

20. The Council's total debt outstanding at 31 March 2023 was £138.014m. In addition to this, a liability of £8.117m relating to the PFI scheme and Finance Leases brings the total to £146.131m. The Council's revised CFR position was estimated to be £228.456m, however, the actual out turn position was £228.660m. When comparing this to our actual

borrowing of £146.131m this meant that the Council was "under borrowed" by £82.529m. This "under borrowed" amount was financed by internal borrowing which means that the amount that could have been invested externally was reduced to cover this. The reduced under borrowed position still has the dual effect of reducing costs to the MTFP because borrowing costs are generally greater than investment returns and it reduces counterparty risk by reducing our exposure to banks and other financial institutions.

21. The treasury position at 31 March 2023, including investments compared with the previous year is shown in table 3 below.

Table 3 – Summary of Borrowing and Investments

Treasury Position	**31 March 2022**		**31 March 2023**	
	Principal £m	**Average Rate %**	**Principal £m**	**Net Annualised Average Rate %**
General Debt - Fixed Rate Debt, Market and Public Works Loan Board (PWLB)	124.649	2.66%	113.014	2.53%
Property Fund Borrowing	25.000	1.30%	25.000	1.65%
Total Debt	**149.649**	**2.47%**	**138.014**	**2.41%**
Cashflow Investments up to 6 months	33.400	0.21%	10.045	2.88%
Capital Investments over 6 months	0.000	0.00%	0.000	0.00%
Property Fund Investment - net of costs	29.999	2.21%	29.999	1.99%
Total Investments	**63.399**		**40.044**	
Net borrowing position	**86.250**		**97.970**	

Prudential Indicators and Compliance Issues

22. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:

23. **Gross Borrowing and the CFR –** in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 4 – Gross Borrowing Compared with CFR

	31 March 2022 Actual £m	31 March 2023 Approved Indicator £m	31 March 2023 Actual £m
Gross Borrowing Position	**149.649**	**148.582**	**138.014**
PFI and Finance Lease Liability	**9.232**	**8.117**	**8.117**
Total	**158.881**	**156.999**	**146.131**
CFR	**224.285**	**228.456**	**228.660**
(Under)/over funding of CFR	**(65.404)**	**(71.757)**	**(82.529)**

24. **The Authorised Limit –** The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.

25. **The Operational Boundary –** The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are both acceptable, subject to the Authorised Limit not being breached.

26. **Actual financing costs as a proportion of net revenue expenditure -** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue expenditure. The actual for this indicator has risen from the previous year due to an increase in the Financing costs outturn.

Table 5 – Key Prudential Indicators

	Actual 2021/22 £m	Original Approved Limits 2022/23 £m	Revised Approved Limits 2022/23 £m	Actual Total Liabilities Borrowing + PFI/ leases 2022/23 Maximum £m
Approved Indicator – Authorised Limit	**158.881**	**255.699**	**239.879**	**146.131**
Approved Indicator – Operational Boundary	**158.881**	**185.966**	**156.699**	**146.131**
Financing costs as a percentage of net revenue expenditure	**1.94%**	**1.87%**	**1.87%**	**1.69%**

27. At 31 March 2023 the total liabilities were £146.131m which is below both the approved Authorised Limit and the approved Operational Boundary. The Operational Boundary is the point at which we expect borrowing to be, but it can be lower or higher. Borrowing cannot exceed the Authorised Limit.

28. A further four prudential indicators are detailed in Appendix 1.

Economic Background for 2022/23

29. A summary of the general economic conditions that have prevailed through 2022/23 provided by Link Asset Services, the Council's treasury management advisors is attached at **Appendix 2.**

Summary of the Treasury Management Strategy agreed for 2022/23

30. The revised Prudential Indicators anticipated that during 2022/23 the Council would need to borrow £5.551m to finance part of its capital programme, whereas the actual outturn figure was £8.158m.

31. The Annual Investment Strategy stated that the use of specified (usually less than 1 year) and non-specified (usually more than 1 year) investments would be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

32. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) were included in the report on the Prudential Indicators update these were as follows £50m for 2021/22 and £50m for 2022/23. No other investments of over 1 year duration have been made during 2022/23.

Treasury Management Activity during 2022/23

Borrowing Strategy

33. During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the CFR), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

34. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

35. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years (see table 6 below). However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Table 6 – net borrowing

	Market Loans (incl. other Local Authorities)			Total
	Amount £m	Length of Loan	Interest Rate %	£m
New Loans Taken				
	5.000	1 year	2.30%	
	5.000	1 year	1.25%	
	2.000	1 year	3.00%	
				12.000
Loans Repaid				
	(2.000)	10 years	3.04%	
	(8.500)	5 years	1.38%	
	(5.000)	2 years	0.90%	
	(3.000)	1 year	0.10%	
	(5.000)	1 year	0.25%	
				(23.500)
Total New Borrowing				(11.500)

36. The additional funding was utilised to not replace maturing short term loans.

37. **Summary of Debt Transactions –**The consolidated rate of interest reduced from 2.47% to 2.41% due to the above transactions as some of the debt repaid was at a higher interest rate than the longer term debt still held.

Investment Position

38. **Investment Policy –** the Council's investment policy for 2022/23 is governed by the DLUHC Guidance which has been implemented in the annual investment strategy for 2022/23 approved by Special Council on 17 February 2022. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

39. The investment activity during the year conformed to the approved Strategy and the Council had no liquidity difficulties.

40. Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for. Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further increases in 2023/24.

41. The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that

the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

42. With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a difficult Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

43. Through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

44. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

45. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

46. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office, other local authorities and bank short term notice accounts. Short term investments of up to a year earned interest of £563k on an average balance of £19.575m which equated to an annual average interest rate of 2.88%.

47. The Council also has longer term investments which consist of the property funds and the returns are shown below in Table 7.

Table 7 – Longer Term 6 months to 5 years - Property Funds

	Original Budget 2022/23	Actual 2022/23
Daily average level of Investments	**£29.999m**	**£29.999m**
Interest earned (gross)	**1.080m**	**1.008m**
Average Rate of Return on Investment Interest earned (gross)	**3.60%**	**3.36%**
Average Rate of Return on Investment (net of costs)	**2.81%**	**1.99%**

Performance and Risk Benchmarking

48. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance.

49. The following reports the current position against the benchmarks originally approved.

50. Security – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables was set as follows:

    0.077% historic risk of default when compared to the whole portfolio

51. Table 8 shows that there has been a fluctuation in the historic levels of default over the year although still well below the benchmark. This is mainly due to some longer term investments actually being made for shorter terms, i.e. up to six months rather than 1 year as these investments were better value than longer term investments and were also a better fit with how the Council was expecting to utilise investments. It also shows more emphasis being placed on counterparties with a higher credit rating.

52. The investment portfolio was maintained within this overall benchmark during this year as shown in Table 8.

Table 8

Maximum	**Benchmark 2022/23**	**Actual June 2022**	**Actual October 2022**	**Actual December 2022**	**Actual March 2023**
Year 1	0.077%	0.004%	0.013%	0.005%	0.015%

53. The counterparties that we use are all high rated therefore our actual risk of default based on the ratings attached to counterparties is virtually nil.

54. Liquidity – In respect of this area the Council set liquidity facilities/benchmark to maintain

    (a) Bank Overdraft £0.100M

(b) Liquid short term deposits of at least £3.000M available within a weeks' notice.

(c) Weighted Average Life benchmark is expected to be 146 days with a maximum of 1 year.

55. Liquidity arrangements have been adequate for the year to date as shown in Table 9.

Table 9

	Benchmark	Actual June 2022	Actual October 2022	Actual December 2022	Actual March 2023
Weighted Average life	**146 days to 1 year**	**128 days**	**78 days**	**94 days**	**144 days**

56. The figures are for the whole portfolio of cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice) as well as call accounts that include a certain amount of notice required to recall the funds.

57. Yield - In respect of this area performance indicators relating to interest rates for borrowing and investments were set with reference to comparative interest rates. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

Risk

58. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:-

(a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.

(b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2022/23).

(c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.

(d) The SI requires the Council to undertake any borrowing activity with regard to the CIFPA Prudential Code for Capital Finance in Local Authorities.

(e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services.

(f) Under the Act the Department of Levelling Up, Housing & Communities has issued Investment Guidance to structure and regulate the Council's investment activities.

(g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

59. The Councils Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

60. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Link Group, the Council's advisers, have proactively managed the debt and investments over the year.

Treasury Management Budget

61. There are three main elements within the Treasury Management Budget:-

(a) Long Term capital investments including Property Funds which earns interest, this comprises of the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

(b) Cash flow interest earned – the authority has consistently had positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipts of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.

(c) Debt servicing costs – This is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 10 - Changes to the Treasury Management Budget 2022/23

	£m	£m
Original Treasury Management Budget		**0.637**
Debt		
Reduced interest payable on debt	**(0.525)**	
Investments		
Increase in investment income including property funds etc	**(1.848)**	
Other Costs		
Less reduced brokerage charges	**(0.006)**	
MRP charge	**2.185**	
		(0.194)
Outturn Treasury Management Budget 2022/23		**0.443**

62. The savings relate to a reduction in the interest payable on debt due to reduced debt levels as well as an increase in the interest received on investments due to the cashflow levels. An MRP charge was also necessary to correct previous years under-provision.

Conclusion

63. The Council's treasury management activity during 2022/23 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £0.194m achieved from the original MTFP.

Outcome of Consultation

64. No formal consultation has been undertaken regarding this report.

Appendix 1

Additional Prudential Indicators not reported in the body of the report

		2021/22 Actual	2022/23 Approved Indicator	2022/23 Outturn
1	**limits on fixed interest rates**	**84%**	**100%**	**88%**
2	**limits on variable interest rates**	**16%**	**40%**	**12%**
3	**Maturity structure of fixed interest rate borrowing (upper Limit)**			
	Under 12 months	**16%**	**40%**	**12%**
	12 months to 2 years	**19%**	**50%**	**12%**
	2 years to 5 years	**19%**	**60%**	**20%**
	5 years to 10 years	**29%**	**90%**	**27%**
	10 years and above	**100%**	**100%**	**100%**
4	**Maximum Principal funds invested greater than 364 days**	**£50m**	**£50m**	**£50m**

Appendix 2

The Economy and Interest Rates

UK. Economy.

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

USA. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

Glossary of Terms

Capital Financing Requirement (CFR)	This is the Councils underlying need to borrow which can be traced back to the Councils Balance Sheet and the value of the Councils assets which have yet to be paid for.
Minimum Revenue Provision (MRP)	Monies set aside from the revenue budget to repay accumulated debt.
Call	Investments that can be returned without a period of notice
Counterparty	Institutions, Banks etc. that with make investments or take out loans with.
Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un-rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cash flow
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.
Gilts	Government Borrowing Bonds
SONIA	The Sterling Overnight Index Average – generally a replacement set of indices (for LIBID) for those benchmarking their investments.
Spreads	The difference between the highest rate of interest and the lowest rate of interest earned/charged on any one particular maturity period i.e. 1 year, 2 year 5 year etc.
LIBID	London Interbank Bid Rate. The average rate at which a bank is willing to borrow from another bank.
LIBOR	London Interbank Offer Rate. The average rate at which a bank is willing to lend to another bank. LIBOR is always higher than the corresponding bid rate and the difference between the two rates is known as the spread.